The Conservative Strategist

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The blinding light at the end of the tunnel

Safe and effective vaccines have been developed ahead of schedule and are on their way. Herd immunity (variously estimated at 40% to 70% of the population) looks likely in 2021, perhaps even by the end of summer. This is one of those rare historical moments when the entire world looks into the near future and sees hope and healing. But in the financial world, this widespread anticipation has supercharged markets that have already been goosed by a combination of trillions in fiscal and monetary stimulus, and an at-home, antsy investing public.

There are now bubbles everywhere.

Exhibit A: The FANMAGs

Back in mid-February, the S&P 500 was trading at its then highest level ever, and at a valuation exceeded only by the dot-com bubble high in 2000. Then the pandemic hit. So ten months into this mess, and amidst a second wave of the virus, we're trading much lower, right? No. The S&P is 10% *higher* than it was in February. And nearly all of those ten percentage points come from just 6 stocks in the 500-stock index: *FaceBook, Apple, Netflix, Microsoft, Amazon,* and *Google.* Their collective value, one-quarter of the S&P, now exceeds every foreign country's entire stock market except Japan.

Exhibit B: Tesla

Tesla's stock has risen nearly 800% in 2020, the biggest rise ever in such a short time for a company that size. Elon Musk is now the second richest person in the world. How nutty is this? Consider the chart above. Tesla's stock market value now exceeds that of the so-called Nifty Nine. That is, investors are willing to pay more for Tesla than *all of the nine largest carmakers in the world — combined.* Never mind that they produce *121 times more cars* than Tesla. And never mind that Tesla until recently has not even produced a quarterly profit. Never mind too that some of these companies are producing well-reviewed electric vehicles of their own.

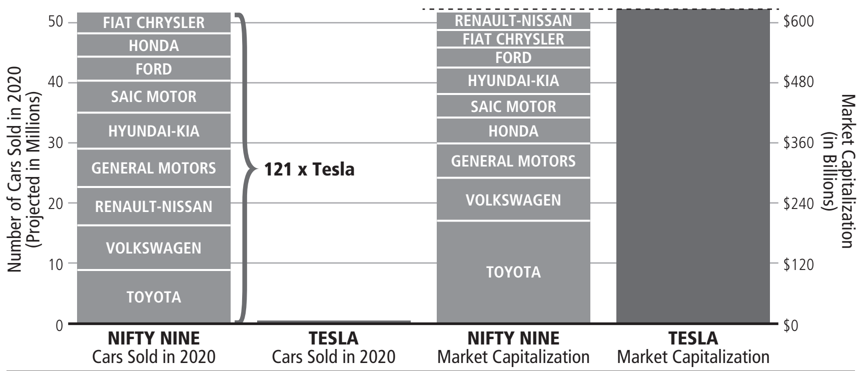
Exhibit C: SPACs

Special Purpose Acquisition Companies (SPACs) go public and raise money with only a vague statement of purpose of finding a company to acquire or merge with. They're also called Blank Check IPOs, because investors essentially invest on faith, based on the reputation of the sponsor and the soundness of the idea. Crazy, right? They've been around for more than two decades and have never really caught on — until the anything-goes market of 2020. Fully 175 SPACs have already gone public in 2020, raising more than $65 billion, which exceeds what they've raised in the prior decade. Predictably, quality is suffering.

Ironically, our single best idea for 2021 (discussed on pages 2 and 3) is an ultra-conservative way of using the SPAC rules to our advantage. ■

Tesla eats the world

Tesla sales, market cap, compared to nine largest car companies *Source: Research Affiliates, LLC*



The Markets	December 31, 2020	Price/Yield	Gain, Qtr	Gain, 2020
US Stocks (S&P 500/Vanguard Index)		3756.07	12.12%	18.25%
International Stocks (Vanguard Index)		19.40	16.87%	11.16%
Emerging Markets Stocks (Vanguard Index)		31.75	16.81%	15.05%
Real Estate Stocks (Vanguard REIT Index)		28.23	9.24%	-4.78%
Bonds (30 year US Treasury/Vanguard Index)		1.65%	-2.86%	18.03%
Dollar (US Dollar Index)		89.94	-4.21%	-6.69%
Gold (London Afternoon Fix)		$1887.60	0.04%	24.61%
Money Market Funds (Vanguard Prime – SEC yield)		0.00%	-0.01%	-1.71%*

*change in yield

SPAC arbitrage: A conservative strategy in a crazy market

A wealthy investor once told me that his key to success was being conservative in asset classes dominated by aggressive investors, and aggressive in asset classes dominated by conservative investors. Special Purpose Acquisition Companies (SPACs) are certainly one of the higher-risk corners of the market. Also called Blank Check companies, they can entail a high degree of uncertainty once a sponsor settles on a merger or acquisition with the proceeds from the Initial Public Offering (IPO).

But there's a conservative approach to this market. Between the IPO and the time a deal is announced (usually 12 to 18 months, though it can be as long as 24 months), the SPAC price tends to accrete rather steadily. Why? Because all SPACs give early investors a kind of free bailout: **When a deal is announced, a holder of the SPAC can elect not to participate, and instead redeem his/her SPAC equity shares for the original IPO price, plus T-Bill interest.**

It gets better. In a SPAC IPO, investors receive not shares but units, almost always at $10 per unit. Each unit consists of one share of stock, and one warrant (or at least a fraction of one warrant) that entitles the holder to buy another share of stock for $11.50 any time within five years of an announcement of a deal.

Call me Warrant Buffer

If a holder elects to bail out, he/she gets back $10 plus T-Bill interest for each share of the SPAC owned. A better than breakeven proposition right there. **But he/she can keep the warrants.** And the warrants, with five-year lives, can have substantial value, often trading at a dollar or more even if the stock has not appreciated much. So the investor can make a total return of 5% to 10% or more on even a mediocre SPAC investment just on the appreciation of the warrants.

The most common SPAC arbitrage trade is to buy a wide array of different SPACs at their original $10 price, building a kind of *SPAC ladder.* Then, as deals are announced and public excitement is at its height, SPAC units (and remember, each is a combination of a stock share *and* at least a fraction of a warrant) can trade at $10.50, $11, even $12 or more for a hot deal. The arbitrageur sells the units into the enthusiasm, pockets a solid profit for a 12-month or 18-month trade, and uses the proceeds to buy a new SPAC IPO. And always there's the hard backstop of $10 per share for the shares alone. (It should be mentioned that in the rare event that a sponsor does not find a suitable merger or acquisition by the normally 24-month deal deadline, then again holders of SPAC shares get back $10 per share plus interest, but the warrants have no worth, by definition. So a slightly better than breakeven investment.)

Good company

This favorable risk/reward scenario probably won't be around for long. So far it has attracted to SPAC arbitrage a number of the world's top hedge funds, sovereign wealth funds, and family offices representing ultra-high net worth investors. Our clients can participate through a separately managed account and an ETF, with likely other choices to come. As a low-risk strategy with solid mid-single digit return potential, SPAC arbitrage fits well in our SuperCash allocation. ■

The value in SPAC arbitrage

Investors pay **$10** for one **share** and up to one **warrant** in an IPO

IPO

→ **Cash** is held in a trust account and invested in short-term Treasury bills

After a few weeks, shares and warrants can be traded separately

→ Investors can buy **shares** if they dip below cash value in trust

→ **Warrants** can be flipped for a quick profit or retained in case value rises

DEAL ANNOUNCED

→ **Shares** pop, investors sell

→ **Shares** dip below $10, investors can redeem and still keep **warrants**

VOTE TO APPROVE

Most arbitrage funds exit before deal closes as redemption right then disappears

DEAL CLOSES

→ Merged entity is owned by more long-term minded institutional investors

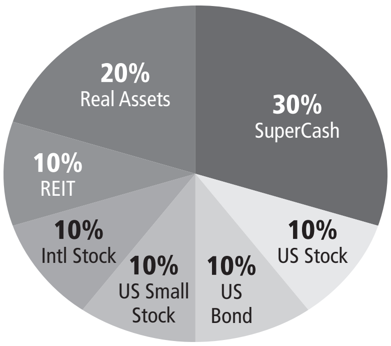
Note: SPAC IPO shares are nearly always sold in units that cost $10.

Sources: Accelerateshares.com; Bloomberg

SuperDiversified Portfolios (SDPs)

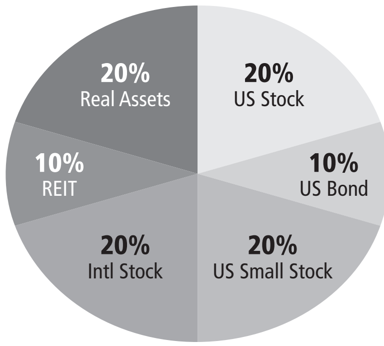
Buffett indicator: Bubble territory

SDP1 ***Conservative***



4th Quarter ***9.31%*** *2020* ***9.67%***

SDP2 ***Moderate***



4th Quarter ***14.36%*** *2020* ***12.76%***

As we've discussed many times in these pages, Warren Buffett's favorite measure of whether the stock market is cheap or pricey is the size of the stock market *vs.* the size of the economy. He measures this by comparing the total value of corporate equities to the Gross Domestic Product (GDP).

Currently, that ratio is 1.81, the highest level ever. It's so high that even if GDP rises 40% and stocks go nowhere, it would still rank higher than all other highs except the dot-com bubble. By the way, in out-of-favor Europe that ratio is in the 0.4 to 0.6 range.

The above model portfolios are not intended to indicate the performance of any real account, but reflect the composite performance, before fees, of the percentage allocations in the asset classes and funds listed in the table below. Seasonal Strategy's actual allocations vary from these models, and among portfolios.

How the Sectors Performed

The stealth rally in bond yields

Asset Class	Mutual Fund	Performance 4th Quarter '20	Performance 2020	
SuperCash	PIMCO Instl Low Duration	0.42%	3.31%	Best
	Merger	3.19%	4.87%	Worst
	Calamos Market Neutral	1.97%	5.18%	
US Stock	Vanguard Index Trust 500	12.12%	18.25%	
US Bond	Vanguard Long-Treasury	-2.86%	18.03%	
US Small Stock	Vanguard Small-Cap Index	27.05%	18.96%	
Intl Stock	Vanguard Intl Index	16.87%	11.16%	
REIT	Vanguard REIT Index	9.24%	-4.78%	
Real Assets	PIMCO Commodity Real Return	12.57%	0.42%	

Last quarter in this space I warned that Treasury bonds were so expensive that they offered return-free risk, and that a rise in yields would result in substantial capital losses for Treasury investors. That rise is quietly in motion.

This quarter, the five-year Treasury yield rose from 0.28% to 0.36%, the ten-year from 0.67% to 0.93%, and the 30-year from 1.46% to 1.70%. Not huge moves, though substantial on a relative basis. The ten-year yield in particular is up nearly 40% since September 30.

SPACs two ways

There are currently two ways to go for SPAC arbitrage: A separately managed account, or a new ETF. Both are less than perfect. The separately managed account does SPAC arb right, but is available only to our clients at *Schwab Institutional,* and only for accounts of $250k or above. The ETF on the other hand is widely available and in any size. It's also surprisingly liquid for a new ETF. But it is brand new (six days old at this writing) and its strategy is what we may call quasi-arbitrage.

The SPAC managed account

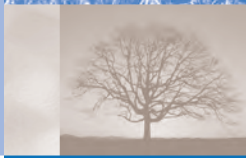
WealthSpring Capital offers a separately managed account program they call *Treasuries + Alpha,* which is as close to pure SPAC arbitrage as I think we can get. *WealthSpring* builds for each client a laddered portfolio of newly issued SPACs, buying as close to $10 as possible. Then it patiently holds the portfolio until each SPAC announces a deal to acquire or merge with a company. Upon that announcement (usually 12 to 18 months after the new issue), the SPAC price usually (but not always) jumps, and then *WealthSpring* sells that SPAC and reinvests the proceeds in a newly minted SPAC.

WealthSpring is run by Matthew Simpson, CFA, who has experience trading on the structured product desks for *DeutscheBank* and *Mitsubishi Securities.* The program charges no management fee, but a 20% performance fee. We like the alignment with client interests.

The ETF

Tuttle Tactical Management runs the actively managed *SPAC* and *New Issue ETF* (SPCX), which expects to be at least 80% invested in SPACs. Because of the limitations of the ETF creation and redemption mechanism, SPCX isn't always invested in the most newly-minted SPACS, but it strives to buy them early in their lifestyle, and like *WealthSpring,* sell them as they pop and recycle the capital in younger SPACs.

SPCX carries a 0.95% expense ratio, has about $10 million spread among 43 issues as of late December, with a 10% cash position ready to invest in the onslaught of new SPAC issues expected in January.



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SECURE Act 2.0 should pass in 2021, improve retirement savings

Hollywood loves sequels. They're reliable box office. Similarly, when Congress has a bipartisan "hit", it's often followed by subsequent legislation. Hence SECURE Act 2.0.

In 2019, the Setting Every Community Up for Retirement Act (SECURE) easily passed a divided Congress (see graph). It raised the age at which one must take required minimum distributions (RMDs) from 70½ to 72, it eliminated the age 70½ restriction on contributions to an IRA, and it enhanced small business's ability to enroll and reward employees and save on setting up new plans. (It also took something away: The so-called Stretch IRA, which allowed non-spouse heirs to stretch distributions over their lifetimes. Instead, it limited the stretch to ten years).

The sequel

Here comes SECURE Act 2.0, which like a sequel, has its own name: The Securing a Strong Retirement Act. Introduced by Representatives Richard Neal (D-MA) and Kevin Brady (R-TX), it builds on the original SECURE Act and is designed to make retirement savings more convenient, more flexible, and more productive. For our clients, the main takeaways are:

- The RMD would be lifted again, from age 72, to age 75, for 401k, 403b, and IRA holders, which will enable much more pre-distribution planning, such as Roth conversions.
- For those who have less than $100,000 total in retirement accounts, RMDs would be eliminated.
- Catch-up contributions for those *over age 60* would rise from $6,500 to $10,000 for 401k and 403b holders, and from $3,000 to $5,000 for SIMPLE IRA plan participants. (Catch-up limits for ages 50-60 would remain at $6,500 and $3,000 respectively). For regular IRAs, over age 50 catch-up contributions increase $1,000 — and then index further increases for inflation, starting in 2022.
- The amount of a Qualified Longevity Annuity Contract (QLAC), a form of longevity insurance, that one can purchase inside a retirement account would increase.

Other benefits for retirement plan participants

SECURE 2.0 will increase incentives for small businesses to enroll participants automatically and increase their contributions over time. This so-called "nudge" would allow for opt-out, but as a default it will increase participation and thus savings rates. It also gives small businesses enhanced credits for offering and maintaining plans.

Ingeniously, it allows those struggling with student loan debts to receive matching contributions to their retirement account, dollar for dollar against their loan payments (up to a limit).

But the four bullet-pointed provisions above are the big takeaways for older savers like our clients.

Congress doesn't agree on much — SECURE Act 2.0 is a rare exception. **Look for its passage in 2021.** ■

Original SECURE Act sailed through Congress in 2019. SECURE 2.0 should, too.

The SECURE Act passed in the House under H.R. 1994: Setting Every Community Up for Retirement Enhancement Act of 2019 on May 23, 2019. It then passed in the Senate as part of H.R. 1865: Further Consolidated Appropriations Act, 2020 on Dec. 20, 2019. Source: GovTrack